In the Supreme Court of the United States

OCTOBER TERM, 1953

No. 423

LLOYD M. BENTSEN, SR., ET AL., PETITIONERS

v.

EMERY C. BLACKWELL, ET AL.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

MEMORANDUM FOR THE SECURITIES AND EXCHANGE COMMISSION, AMICUS CURIAE

The Solicitor General submits this memorandum on behalf of the Securities and Exchange Commission, *amicus curiae*, with respect to the petition for a writ of certiorari filed herein.

The Commission participated as *amicus curiae* both in the District Court and in the Court of Appeals, and believes that the decision below is entirely correct. It recognizes, however, that on the sole question on which petitioners seek review—*viz.*, the proper construction of the clause in Section 12 (2) of the Securities Act of 1933 dealing with interstate commerce and the mails—the decision below conflicts with that of the Court

of Appeals for the Seventh Circuit in *Kemper* v. *Lohnes,* 173 F. 2d 44. While the Commission regards the *Kemper* decision as erroneous, in view of the conflict it does not oppose review limited to that single question.

The question presented arises on a motion to dismiss a complaint asserting fraudulent sales of "securities" in the nature of "investment contracts". The following is alleged: Petitioners control a purported citrus fruit development in the Rio Grande Valley of Texas in which respondents invested substantial sums of money (R. 21–24). Respondents are members of the investing public. They reside in other parts of Texas and had no familiarity with this citrus promotion other than that obtained from petitioners' salesmen (R. 3–4). Each of them was offered a unit or units of land in the development,[1] together with a "care contract" therefor. The promoters undertook, pursuant to the care contracts, to cultivate and develop these units on behalf of the investors, and to harvest and market the crop (R. 3, 17, 18, 46). They told prospective investors that "by investing in said Citrus Development * * * [they] could get in on an 800-acre unit which would be developed by one company in a uniform manner and under the management of citrus experts, for the joint benefit of all inves-

[1] A unit encompassed a 20-acre parcel priced at $400.00 per acre.

tors", and that the investors "would not have a thing to worry about" (R. 17–18). They represented that they "would take care of all the problems which might arise, and the investor would only have to sit back and reap the dividends" (R. 18). It was further represented that the property would be paying all of its expenses within three years, and that the "investment would produce a minimum of 20% per year return * * * after five years" (R. 17). To induce respondents to invest their moneys, numerous fraudulent misrepresentations were made as to the character, quality and value of the acreage, the available supply of water, the quality of citrus stock to be planted, the care and management to be provided, and the prospects of profits (R. 16–21). Respondents paid for their land parcels immediately—in cash or by a combination of cash and interest bearing vendor's lien notes. Payments on the care contracts, however, were placed on a periodic basis (R. 5–16). Each investor was required to deposit sufficient funds in a bank account held jointly with the promoters to meet the investor's financial commitments under the care contract (*ibid.*). The misrepresentations which induced the sales were made orally (R. 18); but the promoters used the mails to transmit the warranty deeds for the parcels of land, the care contracts, and the periodic billings or statements on said contracts (R. 19). The periodic billings

themselves, according to the complaint, contained further misrepresentations to deter withdrawals from the investment agreements (R. 18–19). After large sums of money had been obtained from public investors, the venture collapsed as the result of the lack of skilled labor and essential equipment, and of general neglect on the part of the promoters (R. 19–20). By the instant action, investors seek to obtain rescission or recover damages (R. 24–26).

Petitioners challenged the sufficiency of the complaint on a number of grounds which included (1) the failure to allege transactions describing sales of "securities" within the meaning of the Securities Act of 1933, and (2) the failure to allege that the mails were used to transmit the misrepresentations complained of so as to render applicable the civil liabilities provisions of Section 12 (2) of the Act (15 U. S. C. 77*l* (2)) (R. 26–30). Agreeing with petitioners on these two grounds, the District Court dismissed the complaint (R. 54–71). The Court of Appeals, however, rejected petitioners' contentions, reversed the District Court, and remanded the case for trial on the merits. *Blackwell* v. *Bentsen,* 203 F. 2d 690 (R. 81–87).

The Court of Appeals concluded that the transactions alleged fell well within the area of "investment contracts" delineated by this Court in *S. E. C.* v. *W. J. Howey Company,* 328 U. S.

293, and *S. E. C.* v. *C. M. Joiner Leasing Corp.*, 320 U. S. 344. It took cognizance of the *Kemper* decision in the Seventh Circuit on the mailings question, but refused to follow it. Instead, it followed the decision of the Court of Appeals for the Second Circuit in *Schillner* v. *H. Vaughan Clarke & Co.*, 134 F. 2d 875, and held that the alleged uses of the mails to transmit the deeds and care contracts to consummate the transactions were sufficient to afford jurisdiction under Section 12 (2).

While petitioners deny that there have been sales of securities and characterize the controversy as simply a "local land dispute", the position they take at this time is that—

> * * * this question is basically one of construction of the pleadings and we do not believe that it is of sufficient consequence to merit the attention of this Court under its rules. We therefore confine this petition to the error of the court below in holding that use of the mails for incidental delivery of the documents after sale is sufficient basis for federal jurisdiction under Section 12 (2) of the Securities Act of 1933. If it should be necessary after action by this Court, we shall present to the trial court, after evidence, the question of the existence of a security [Pet. 7].

In the Commission's view, there is no need for further review of the decision below as respects the "securities" question; and it would have opposed the grant of a writ of certiorari had it been

sought on that ground. The ruling below on that question is correct and presents no conflict with that of any other court.

As previously stated, the Commission believes that the court below also correctly decided that the alleged uses of the mails to consummate the transactions—*i. e.*, to deliver the documents evidencing the securities, and to obtain part of the purchase moneys—sufficed to bring the transaction under Section 12 (2). Insofar as pertinent that Section provides:

> Any person who * * * sells a security * * *, by the use of any means or instruments of transportation or communication in interstate commerce or of the mails, by means of a prospectus or oral communication, which includes an untrue statement of a material fact or omits to state a material fact * * * shall be liable to the person purchasing such security from him, * * *.

In light of the statutory purposes to outlaw fraudulent sales of securities and to provide civil remedies therefor to the extent that Congress was constitutionally able to do so,[2] and in the light of the many court decisions holding with unanimity

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[2] Cf. *Fratt* v. *Robinson*, 203 F. 2d 627, 635 (C. A. 9); *United States* v. *Monjar*, 47 F. Supp. 421, 425 (D. Del.), affirmed, 147 F. 2d 916 (C. A. 3), certiorari denied, 325 U. S. 859; *United States* v. *Kott*, 1 SEC Jud. Dec. 228, 229 (S. D. Tex.), reversed on other grounds, *sub nom. Seeman* v. *United States*, 90 F. 2d 88 (C. A. 5).

that these and similar uses of the mails are sufficient to invoke the other fraud provisions of the federal securities laws, including provisions giving rise to civil liabilities,[3] the court below properly concluded that the language in Section 12 (2), "by means of a prospectus or oral communication, which includes an untrue statement of a material fact" etc., refers to the opening clause, "sells a security" and does not modify the jurisdictional clause, "by the use of * * * the mails". To hold otherwise, as these petitioners suggest, would mean that there can be no civil recovery under Section 12 (2) of the Securities Act of 1933 for sales induced by fraudulent misrepresentations made orally, even though the very same conduct constitutes a criminal offense under Section 17 (a) of the statute.[4] It is inconceivable to

[3] See, e. g., *Fratt* v. *Robinson*, 203 F. 2d 627 (C. A. 9); *United States* v. *Earnhardt*, 153 F. 2d 472 (C. A. 7), certiorari denied, 328 U. S. 858; *Bogy* v. *United States*, 96 F. 2d 734 (C. A. 6), certiorari denied, 305 U. S. 608; *Slavin* v. *Germantown Fires Ins. Co.*, 174 F. 2d 799 (C. A. 3); *Northern Trust Co.* v. *Essaness Theatres Corp.*, 103 F. Supp. 954 (N. D. Ill.); *United States* v. *Vidaver*, 73 F. Supp. 382 (E. D. Va.).

[4] Section 17a (15 U. S. C. 77q (a)), provides:

> (a) It shall be unlawful for any person in the sale of any securities by the use of any means or instruments of transportation or communication in interstate commerce or by the use of the mails, directly or indirectly—
>
> (1) to employ any device, scheme, or artifice to defraud, or
>
> (2) to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order

us that Congress intended by the differently worded language of Section 12 (2) (occasioned by the difference in the remedy provided) to impose a more restricted field for civil recovery than that provided for criminal prosecutions. Nor is the text of Section 12 (2) susceptible of petitioners' construction, except possibly by the total disregard of the statutory context. Relevant legislative history, which was discussed in our brief below but upon which we do not elaborate at this time, also appears inconsistent with petitioners' proffered construction.

No analysis of the question was provided by the Court of Appeals for the Seventh Circuit in the *Kemper* opinion, which simply assumed that Section 12 (2) required that the mails be used to transmit the misrepresentations. This is true also of the earlier statement in *Siebenthaler* v. *Aircraft Accessories Corp.*, CCH Fed. Sec. L. Rep. ¶ 90,122 (W. D. Mo.),[5] and the prior dicta in two other cases upon which petitioners rely.[6] In

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to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser.

[5] The actual holding in the *Siebenthaler* case is not clear. There is no positive finding of any fraudulent misrepresentation or omission.

[6] In *Murphy* v. *Cady*, 30 F. Supp. 466 (D. Maine), affirmed, 113 F. 2d 988 (C. A. 1), plaintiff recovered on proof of oral misrepresentations communicated by interstate tele-

contrast, the decision below and that of the Court of Appeals for the Second Circuit in the *Schillner* case (134 F. 2d, at 877–8) are well reasoned. The Court of Appeals for the Ninth Circuit, in dealing with a comparable mailings question in a civil action for a fraudulent purchase of securities brought under the companion anti-fraud provisions of Rule X–10B–5, 17 C. F. R. 240.10b–5, promulgated pursuant to Section 10 (b) of the Securities Exchange Act of 1934, 15 U. S. C. 78j (b), gave consideration to the related question under Section 12 (2) of the Securities Act of 1933, and agreed with the court below that the *Schillner* decision contained "the best reasoning". *Fratt* v. *Robinson*, 203 F. 2d 627, at 634, n. 20. See also *Moore* v. *Gorman*, 75 F. Supp. 453 (S. D. N. Y.).

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phone. Similarly, in *Independence Shares Corp.* v. *Deckert*, 108 F. 2d 51 (C. A. 3), reversed without discussion of point, 311 U. S. 282, the alleged misrepresentations were transmitted by the use of federal instrumentalities. At a later stage of the proceedings the court observed that "The gravamen of the cause of action * * * is the misleading of the purchaser." *Pennsylvania Co.* v. *Deckert*, 123 F. 2d 979, 984. *Gross* v. *Independence Shares Corp.*, 36 F. Supp. 541 (E. D. Pa.), which petitioners also cite, contains nothing specific on the question. Indeed, the court held that the mailing of payment notices and other material designed to induce investors to continue contracts relating to securities sold under an installment payment plan was sufficient. It should be observed that, in the present case, the complaint similarly alleges that the periodic billings on the care contracts contained misrepresentations intended to deter respondents from terminating their investment arrangements.

The Commission was not a participant in the *Kemper* and other cases relied upon by petitioners.

As previously indicated, the Commission does not oppose the grant of a writ of certiorari on the question as to the requisite use of the mails under Section 12 (2) of the Act. However, since the decision below is correct and since the ruling in the *Kemper* case has not been followed, we have not deemed it appropriate to urge affirmatively that the ruling below on that question be reviewed.

Respectfully submitted,

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BRIEF FOR THE SECURITIES AND EXCHANGE COMMISSION, AMICUS CURIAE

OPINIONS BELOW

The opinion of the Court of Appeals (R. 50-54) is reported in 203 F. 2d 690. The opinion of the District Court (R. 34-46) is not reported.

JURISDICTION

The judgment of the Court of Appeals was entered on April 27, 1953 (R. 55). Petitions for rehearing were denied on July 27, 1953 (*ibid.*). The petition for writ of certiorari was filed on October 21, 1953, and granted on December 7, 1953 (R. 56, 346 U. S. 908). The jurisdiction of this Court is invoked under 28 U. S. C. 1254. See also

Section 22(a) of the Securities Act of 1933, 15 U.S.C. 77v (a).

QUESTIONS PRESENTED

1. Whether, under Section 12(2) of the Securities Act of 1933, a purchaser of securities may recover for oral misrepresentations made face to face where the sale was later consummated by use of the mails.

2. Whether the allegations of delivery through the mails of the deeds and contracts, essential parts of the investment contracts here involved, were sufficient to invoke jurisdiction under Section 12(2).

STATUTE INVOLVED

Section 12(2) of the Securities Act of 1933 (the "Act"), 48 Stat. 74, 15 U.S.C. 77l (2), provides:

> Any person who—
>
> * * * * *
>
> (2) sells a security (whether or not exempted by the provisions of section 3, other than paragraph (2) of subsection (a) thereof), by the use of any means or instruments of transportation or communication in interstate commerce or of the mails, by means of a prospectus or oral communication, which includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements, in the light of the circumstances under which they were made, not misleading (the purchaser not knowing of such untruth or omission), and who shall not

sustain the burden of proof that he did not know, and in the exercise of reasonable care could not have known, of such untruth or omission,

shall be liable to the person purchasing such security from him, who may sue either at law or in equity in any court of competent jurisdiction, to recover the consideration paid for such security with interest thereon, less the amount of any income received thereon, upon the tender of such security, or for damages if he no longer owns the security.

Section 17(a) of the Act, 15 U. S. C. 77q(a), provides:

(a) It shall be unlawful for any person in the sale of any securities by the use of any means or instruments of transportation or communication in interstate commerce or by the use of the mails, directly or indirectly—

(1) to employ any device, scheme, or artifice to defraud, or

(2) to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser.

Other statutory provisions are set forth in relevant part in the argument below where necessary.

STATEMENT

The questions presented arise on a motion to dismiss a complaint asserting causes of action under Section 12(2) of the Act for fraudulent sales of securities in the nature of investment contracts. The following facts are alleged in the complaint:

Petitioners control a purported citrus fruit development in the Rio Grande Valley of Texas in which respondents and other members of the buying public were induced to invest substantial sums of money (R. 13-15; 3-10). Respondents resided in other parts of Texas and had no familiarity with this promotion (R. 2).[1] Each respondent was offered a unit or units of land in the development, together with a "care contract" therefor.[2] The promoters[3] undertook, pursuant to the care con-

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[1] While the respondents in this case are alleged to be residents of Texas, petitioners' brief discloses that residents of other states were induced to invest money in the promotion. Thus, petitioners refer to "out of state plaintiffs" in other actions in the federal courts based on "diversity of citizenship" apparently involving the same promotion (Pet. Br. 16).

[2] A unit encompassed a 20-acre parcel priced at $400.00 an acre.

An issue, which is not material here, exists as to whether two of the complainants entered into care contracts (R. 29, 53).

[3] The action was brought against the following defendants: Pummill Development Company, the corporate vendor of the land units; Pummill Management Company, an affiliate which handled the care contracts; Earl and Carl Pummill, directors and stockholders of the foregoing companies; petitioners Lloyd M. Bentsen, Sr., Elmer C. Bentsen, and their firm, Bentsen Development Company, who allegedly controlled the Pummills and the over-all operations of the promotion; and certain other individuals who allegedly participated in the transactions as agents, employees, or co-conspirators (R. 1, 13-15). Defendants, other than the instant petitioners, did not seek a writ of certiorari.

tracts, to cultivate and develop these units on behalf of the investors, and to harvest and market the crop (R. 10-11; 29-33). They told prospective investors that "by investing in said Citrus Development * * * [they] could get in on an 800-acre unit which would be developed by one company in a uniform manner and under the management of citrus experts, for the joint benefit of all investors", and that the investors "would not have a thing to worry about" (R. 10-11). They represented that they "would take care of all the problems which might arise, and the investor would only have to sit back and reap the dividends" (R. 11). It was further represented that the property would be paying all of its expenses within three years, and that the "investment would produce a minimum of 20% per year return * * * after five years" (R. 10-11).

To induce respondents to invest, fraudulent misrepresentations and misleading omissions of material facts were made as to the character, quality, and value of the acreage, the available supply of water, the quality of citrus stock to be planted, the care and management to be provided, and the prospects of profits (R. 10-13). Respondents paid for their land parcels in cash or by a combination of cash and interest-bearing vendor's lien notes. Payments on the care contracts, however, were placed on a periodic basis. (R. 3-10.) In this connection, each investor was required to deposit from time to time in a bank account held jointly with the promoters sufficient funds to meet his

financial commitments under the care contract (*ibid.*).

The misrepresentations which induced investors to enter into the investment contracts were made orally (R. 11); but the promoters used the mails to transmit the warranty deeds for the parcels of land, the care contracts, which bore dates later than those on the deeds, and the periodic billings or statements on said contracts (R. 11-12).[4] The periodic billings themselves, according to the complaint, contained further misrepresentations to induce continued payments under the investment arrangements and to deter withdrawals therefrom (R. 12). After large sums of money had been obtained from public investors, respondents discovered that the venture was doomed to failure because of the lack of suitable water, skilled labor and essential equipment, and general neglect and abandonment on the part of the promoters (R. 12-13). By the instant action, investors seek to obtain rescission or recover damages (R. 15-16).

Petitioners and others named as defendants challenged the sufficiency of the complaint on a number of grounds including: (1) a failure to allege sales of "securities"—"investment contracts" in this case—within the meaning of the Act; and (2), a failure to allege that the mails were used to transmit the particular misrepresentations complained of, which, they contended, was necessary to render

[4] The petitioners' statement (Pet. Br. 5) that the deeds were mailed only after being recorded in the investors' names goes beyond the complaint and, in any event, is immaterial here. See pp. 37-38, *infra*.

applicable the civil liabilities provisions of Section 12(2) (R. 16-19, 23). Agreeing with the defendants on these two grounds, the District Court dismissed the complaint (R. 34-46). The Court of Appeals, however, rejected both contentions, reversed the District Court, and remanded the case for trial on the merits (R. 50-54).

The Court of Appeals concluded that the interests sold fell well within the area of "investment contracts" delineated by this Court in *S. E. C.* v. *W. J. Howey Company,* 328 U. S. 293, and *S. E. C.* v. *C. M. Joiner Leasing Corp.,* 320 U. S 344 (R. 52-54). It held, further, that the alleged uses of the mails to transmit the deeds and care contracts to consummate the transactions were sufficient to bring the sales within the scope of Section 12(2) (R. 54).

Petitioners sought a writ of certiorari "confine[d] * * * to the error of the court below in holding that use of the mails for incidental delivery of documents after sale is sufficient basis for federal jurisdiction under Section 12(2) of the Securities Act of 1933" (Petition, p. 7). Petitioners also expressed disagreement with the Court of Appeals that there had been sales of securities and sought to characterize the controversy as simply a "local land dispute", but stated that certiorari was not sought on that ground. Although their brief on the merits contains similar references to "local land disputes", the argument is confined to the ruling below on the sufficiency of the use of the mails.

The Securities and Exchange Commission, as *amicus curiae,* filed briefs in both courts below expressing agreement with the views which the Court of Appeals subsequently adopted. The Commission also filed, as *amicus curiae,* a memorandum on the petition for certiorari. It did not oppose review of the ruling on the sufficiency of the uses of the mails in light of the conflict with an earlier holding of the Court of Appeals for the Seventh Circuit in *Kemper* v. *Lohnes,* 173 F. 2d 44 — a holding which the Commission regards as clearly erroneous and which the court below declined to follow.

SUMMARY OF ARGUMENT

The court below correctly decided that the alleged use of the mails to consummate the sales by delivery of the deeds and care contracts sufficed to bring the transactions within the provisions of Section 12(2) of the Securities Act of 1933.

I

Both the text and context of Section 12(2) lead to the conclusion that the cause of action afforded by that section is not dependent upon use of the mails or facilities of interstate commerce to transmit the misrepresentations, and that a mailing elsewhere in the sale transaction is sufficient.

As a matter of grammar, the third phrase "by means of a prospectus or oral communication, which includes an untrue statement of a material fact," modifies solely "sells a security" and is not merely an extension of the second phrase "by the

use of any means or instruments of transportation or communication in interstate commerce or of the mails." The language "sells * * * by the use of any means * * * of *transportation* or communication * * *," and the broad preamble reference to "securities sold * * * through the mails," further negate petitioners' contention that there must be fraudulent communication by use of one of the stated instrumentalities.

The correctness of the above construction is shown also by the statutory context. The civil recovery provisions of Section 12(2) are but part of an integrated program designed to obtain informed and honest dealings in securities. The registration provisions of the Act require disclosure of pertinent information in connection with offerings to the public so that an investor may have an opportunity to exercise an informed judgment. Other provisions of the Act, including Section 12(2), are designed to curb fraud and deception in the sale of securities generally. Section 17(a) renders fraudulent and deceptive sales unlawful, and Section 12(2) authorizes civil recovery. While Congress has deemed it appropriate to exempt certain securities and transactions from the registration requirements of the Act, it has expressly provided that there are to be no exemptions from the antifraud provisions of Section 17(a), and but one exemption, not material here, from the civil recovery provisions of Section 12(2). Thus, the exemption from registration afforded for purely intrastate sales of securities locally issued is not available

under the provisions of Sections 12(2) and 17(a) which are designed to curb fraud. Congress, of course, has power to legislate with respect to intrastate uses of the mails; and petitioners do not deny that it has made unlawful under Section 17 (a) the use of the mails in a fraudulent sale of securities whether or not such use involves the transmission of the misrepresentations complained of. Section 12(2), which is the civil recovery counterpart of Section 17(a), was clearly intended to have the same broad scope.

The legislative history shows that the provisions relating to the uses of the stated federal instrumentalities were intended to afford constitutional support for the broad program adopted, and that Congress intended to make *full use* of its constitutional powers to achieve, through Section 12(2) as well as other provisions, the remedial objectives of the legislation.

Petitioners' proffered construction, based on a strained reading of Section 12(2), would frustrate the remedial purposes of the statute and lead to absurd and wholly incongruous results. It would deprive public investors of the benefits of the civil action provided by Section 12(2) in the case of oral misrepresentations, except in instances such as those involving a conversation across a state line or one over an interstate telephone. Under petitioners' interpretation, a fraudulent promoter could use the mails in selling securities to public investors, but yet avoid civil liability under Sec-

tion 12(2) by making his representations orally rather than in writing. Petitioners' construction would also mean that no civil liability would accrue under Section 12(2) for "face to face" misrepresentations in the sale of securities even though, as petitioners concede, the very same conduct violates Section 17(a) and is a criminal offense, and even though such misrepresentations if made in the *purchase* of the securities, rather than in the sale, would enable the defrauded seller to obtain civil recovery pursuant to the companion anti-fraud provisions of Rule X-10B-5 under Section 10(b) of the Securities Exchange Act of 1934. Moreover, contrary to petitioners' assertion, the relegation of investors to the remedies available at common law or under state statutes would cause them to lose important rights. Section 12(2) accords a defrauded investor a more simple and effective right of action than that given by the common law; and provides many advantages not afforded by the Texas Securities Act to which petitioners refer.

All but one of the actual court holdings support the view that the misrepresentations need not be communicated through interstate facilities or the mails if either instrumentality has been, or is later, used elsewhere in the sale transaction. The one court of appeals' ruling to the contrary, and a few other cases containing language which paraphrases Section 12(2) restrictively, offer no analysis of the statutory considerations and are entitled to little weight.

II

The alleged uses of the mails to deliver the deeds and care contracts—essential parts of the investment contracts—were mailings in the sale of the securities within the ambit of Section 12(2). Petitioners' suggestion that delivery of the documents is not part of the sales transaction because it confers no additional rights lacks merit as a general proposition and, moreover, ignores allegations in the complaint to the effect that the care contracts, at least, were not completed until the delivery.

The basic statutory definition of "sale" and "sell" includes a "disposition of * * * a security * * * for value" (Sec. 2(3)). The companion anti-fraud provisions of Section 17(a) and Rule X-10B-5 have been uniformly construed to apply where the mails have been used to deliver the securities even after the contract has been completed. This has also been the construction of Section 12(2) by the courts which have held sufficient under that section, too, use of the mails at any point in the sale of the security. An early district court statement to the contrary gave no consideration to the statutory definition, but relied instead upon particular language in the special context of the registration provisions of Section 5(a)(2). That statement, however, has since been rejected by other courts which have construed Section 12(2) in the light of the purpose of the Act.

ARGUMENT

I. Civil Recovery under Section 12(2) of the Securities Act of 1933 Is Not Dependent upon Use of the Mails to Transmit the Misrepresentations, it Being Sufficient that the Mails Were Used Elsewhere in the Sale Transaction.

The controversy relates to the proper construction of the first three clauses or phrases of Section 12(2) which, for purposes of this discussion, are separated in the excerpt set forth below:

> Any person who * * * sells a security * * *,
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> by the use of any means or instruments of transportation or communication in interstate commerce or of the mails,
>
> by means of a prospectus or oral communication, which includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements, in the light of the circumstances under which they were made, not misleading * * *
>
> shall be liable to the person purchasing such security from him * * *.

Under the construction adopted by the court below, clauses two and three independently modify "sells a security." As a matter of grammar, this is warranted by the comma between these two clauses, by the absence of qualifying language, and by the commencement of both clauses two and three with the preposition "by" which indicates that each was intended independently to modify the initial verb.

Petitioners urge, however, that clauses two and three should be read as a single phrase as though the comma were omitted, or as if the language of the section were inverted as follows:

> Any person who * * * sells a security * * * by means of a prospectus or oral communication * * * [transmitted] by the use of any means or instruments of transportation or communication in interstate commerce or of the mails shall be liable to the person purchasing such security from him * * *.

Petitioners' construction strains the language of Section 12(2); but if there is doubt as to the correctness of our reading of the section it can readily be resolved by consideration of the purpose of the provision, its history, and reference to the parallel provisions of the Securities Act and the Securities Exchange Act. Petitioners' intepretation goes a long way towards frustrating the remedial objectives of the Act. Thus, it would deprive public investors of the benefits of the civil recovery provisions of the Act where the misrepresentations have been oral, except in instances such as interstate telephone conversations or conversations across state lines. It would mean that civil recovery under the statute would not be available for "face to face" misrepresentations in the sale of securities to public investors even though, as petitioners do not deny (Pet. Br. 14-15), the very same conduct by the fraudulent seller is a criminal offense under Sections 17(a) and 24 of the Act, and even though such misrepresentations give rise to civil liabilities

under the companion anti-fraud provisions of Section 10 (b) of the Securities Exchange Act of 1934 (15 U.S.C. 78j(b)) and the regulations issued thereunder, if made in the *purchase*, rather than in the sale, of securities (see *infra*, pp. 23-26). The construction urged by petitioners has been expressly rejected by two courts of appeals [5] and disapproved by a third in a reasoned dictum. [6] It has been upheld by only one court of appeals which assumed the construction without discussion of the underlying statutory considerations. [7] These and other cases are discussed *infra*, pp. 33-37.

In construing Section 12(2), consideration should be given not only to the bare text, but also to the purpose of that section and its relationship to the other provisions of the Act. As this Court has emphasized, it is necessary to read "text in the light of context and [to] interpret the text so far as the meaning of the words fairly permits so as to carry out in particular cases the generally expressed legislative policy." [8]

The civil liabilities provisions of Section 12(2) are but part of a broad integrated program designed to obtain "honest dealing in securities." [9] The program has two major aspects: one relates to disclosure of pertinent information in connection with new offerings of securities to the public so

[5] The ruling below in the Fifth Circuit, and that in *Schillner* v. *H. Vaughan Clarke & Co.*, 134 F. 2d 875, in the Second Circuit.

[6] *Fratt* v. *Robinson*, 203 F. 2d 627, 634, in the Ninth Circuit.

[7] *Kemper* v. *Lohnes*, 173 F. 2d 44, in the Seventh Circuit.

[8] *S.E.C.* v. *C. M. Joiner Leasing Corp.*, 320 U.S. 344, 351.

[9] H. Rep. No. 85, 73d Cong., 1st Sess., p. 2 (1933).

that investors may have an opportunity to exercise an informed judgment; the other, which applies not only to new offerings but to sales generally, is designed to curb fraud and deception by imposing liability, both civil and criminal, for misrepresentations.

As respects the first of these, before an issue of securities may lawfully be offered to the public full disclosure of all material facts must be made pursuant to the registration provisions of the Act. Sections 5, 6, 7, 8, 10, 15 U.S.C. 77e, 77f, 77g, 77h, 77j. Exemptions from the registration requirements are provided with respect to certain securities and securities transactions which Congress, considering the interests of public investors and other factors, did not deem necessary to subject to those requirements. Sections 3(a), 4, 15 U.S.C. 77c(a), 77d. In addition, the Commission is given discretionary power to exempt from registration any public offering of securities where the aggregate amount of the issue does not exceed $300,000, Section 3(b), 15 U.S.C. 77c(b); and pursuant to Section 3(b) the Commission has issued appropriate regulations conditioning the exemption upon the filing of certain information with respect to such issues. See, *e.g.*, Regulation A, 17 C.F.R. 230.215 *et seq.* (18 Fed. Reg. 1434). Violations of these as well as other provisions of the Act, or the Commission's rules or regulations thereunder, may be enjoined by the Commission, Section 20(b), 15 U.S.C. 77t(b), and, if willfully committed, may give rise to criminal prosecution, Section 24, 15 U.S.C. 77x. Civil liability

for selling a security without complying with the registration requirements of the Act is provided by Section 12(1), 15 U.S.C. 77l(1). Misrepresentations or omissions of material facts in registration statements which have become effective under the Act give rise to civil liabilities under Section 11, 15 U.S.C. 77k.

The legislative program against fraud and deception in the sale of securities generally, however, is broader. Sections 17 and 12(2) of the Act, 15 U.S.C. 77q, 77l(2), respectively render unlawful, and authorize civil recovery for, fraud and misrepresentation in the sale of securities even with respect to securities and securities transactions which are exempted from the registration requirements. Thus, it is expressly provided in subparagraph (c) of Section 17 that the exemptions from other provisions of the Act shall not be applicable as respects the broad prohibitions of that section. Similarly, Section 12(2), with one exception not material here, [10] expressly renders those exemptions inapplicable as respects the corresponding broad civil liabilities provisions. For example, Congress has seen fit to exempt from the registration requirements purely intrastate sales of securities locally issued; [11] but such sales are clearly subject to the

[10] The sole exception is for government and bank securities exempted from the statute by Section 3(a)(2), 15 U.S.C. 77c(a)(2).

[11] Section 3(a)(11), 15 U.S.C. 77c(a), provides:

> Except as hereinafter expressly provided, the provisions of this title shall not apply to any of the following classes of securities:
>
> * * * * *

(Cont'd next page)

prohibitions of Section 17 against fraud and the provisions of Section 12(2) for civil recovery. The considerations which led Congress to exempt such purely intrastate transactions from the burden and expense of the federal registration requirements obviously were not regarded as sufficiently persuasive to warrant similar exemption from the broad statutory program against fraud and misrepresentation. Here is clear statutory negation of the argument, and innuendo, which pervade petitioners' brief that Congress did not intend to deal with fraud in the field of intrastate sales of securities.

The "statutory policy" has been described by this Court as that "of affording broad protection to investors." *S.E.C.* v. *W. J. Howey Co.*, 328 U. S. 293, 301. To effectuate this policy, Section 12 (2) affords an investor a more simple and effective right of action than that available at common law. *Wilko* v. *Swan*, 346 U. S. 427, 431.[12] The civil

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([11]) Any security which is a part of an issue sold only to persons resident within a single State or Territory, where the issuer of such security is a person resident and doing business within, or, if a corporation, incorporated by and doing business within, such State or Territory.

[12] In holding that the special court remedy afforded by Section 12(2) may not be waived by a pre-sale stipulation for arbitration obtained by the seller, the Court observed that the Securities Act "added to the ancient rule of *caveat emptor* the further doctrine of 'let the seller also beware' • • • " "Section 12(2)," the Court noted, "created a special right to recover for misrepresentation which differs substantially from the common-law action in that the seller is made to assume the burden of proving lack of scienter. The Act's special right is enforceable in any court of competent jurisdiction—federal

liability provision of the Texas Securities Act (Vernon's Tex. Rev. Civ. Stat. Ann., Art. 600a, § 33a) which petitioners cite (Pet. Br. 15) is hardly "substantially equivalent" (Pet. Br. 16) to Section 12(2); for rescission alone is authorized upon tender of the securities and the income received therefrom, and then for affirmative misrepresentations only, and the procedural advantages of Section 12(2) are not afforded.

With this background, we turn to a more detailed consideration of the provisions relating to the use of interstate instrumentalities or of the mails. The constitutional bases for the legislation, of course, are the power of Congress to regulate interstate commerce (Art. I, Sec. 8, Cl. 3) and its power with respect to the use of the mails (Art. I, Sec. 8, Cl.

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or state—and removal from a state court is prohibited. If suit be brought in a federal court, the purchaser has a wide choice of venue, the privilege of nation-wide service of process and the jurisdictional $3,000 requirement of diversity cases is inapplicable." (*Ibid.*)

See also Frankfurter, *The Federal Securities Act: II*, 8 Fortune 53, 108 (August, 1933):

> For willful violations of the Act there are, of course, criminal penalties. American legislative history, however, proves the very limited function of the criminal law in the assimilation by business of standards of public responsibility. The real needs are the building up of new business habits and the generation of a new moral climate for business. * * * *But an indispensable spur to observance of the standards of the Act is the right of recovery by the victims of disobedience.* * * * *The Act would be merely a pious resolution unless the standards of responsibility for the conduct of the investing business had the sanctions of rigorous civil liability.* [Emphasis supplied.]

7).[13] Federal power with respect to the mails is independent of the power relating to interstate commerce;[14] and, accordingly, it has been held that a purely intrastate mailing suffices to provide jurisdiction under the Securities Act of 1933. *Shaw* v. *United States,* 131 F. 2d 476 (C.A. 9); *Holmes* v. *United States,* 134 F. 2d 125 (C.A. 8), certiorari denied, 319 U.S. 776; *Hunt* v. *Securities and Exchange Commission,* 158 F. 2d 981 (C.A. 9); *Gross* v. *Independence Shares Corp.,* 36 F. Supp. 541 (E.D. Pa.). This the petitioners admit (Pet. Br. 24); nor do they challenge the power of Congress to authorize civil recovery for fraudulent sales of securities in which the mails have been employed, even though the misrepresentations may not have been transmitted through that federal instrumentality. In fact petitioners recognize that Section 17—the injunctive and criminal counterpart of Section 12(2)—has been uniformly construed to apply whenever the mails are used in connection with any part of the transaction (see pages 23-24, *infra*). But Section 17(a), petitioners suggest, is "perhaps more broadly phrased" (Pet. Br. 8). Section 12(2), however, petitioners contend, is limited by the statutory language itself to "a par-

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[13] Petitioners' argument that the postal power was included merely to back up a possibly invalid exercise of the interstate commerce power, apart from the fact that it is wholly beside the point since the use of the mails was included as a basis for jurisdiction whatever the motive, is somewhat disingenuous in light of the prior application of the mail fraud statute to securities transactions.

[14] *Badders* v. *United States,* 240 U.S. 391; *In re Rapier,* 143 U.S. 110.

ticular kind of use of the mails" (Petition, p. 11). So the issue is narrowed to that of the intent of Congress.

It is pointed out above (pp. 13-14 *supra*), that petitioners' proffered construction of Section 12 (2) is unwarranted as a matter of simple grammatical construction. Also, petitioners overlook the use of the language "sells a security * * * by the use of any means or instruments of *transportation* or communication in interstate commerce or of the mails" (emphasis added). This would seem to negate petitioners' contention that Section 12 (2) was intended to apply only where there is fraudulent communication by means of one of the stated federal instrumentalities (Pet. Br. 14); for, on the face of the statute, it appears to have been contemplated that the use of a federal instrumentality for purposes of "transportation" as well as "communication", in connection with the fraudulent sale, would suffice to render the civil recovery provisions applicable. Petitioners also give no consideration to the preamble of the Act which refers to the purpose "To provide full and fair disclosure of the character of securities *sold* in interstate and foreign commerce and *through the mails,* and to *prevent frauds in the sale thereof,* and for other purposes" (emphasis added). 48 Stat. 74. In *Wilko* v. *Swan,* 346 U. S. 427, 431, n. 9, this Court referred, *inter alia,* to this language in discussing the broad remedial objectives of the statute—particularly those of Section 12(2).

Petitioners' construction would frustrate the

remedial objective of Section 12(2). As previously shown, that section is but part of a broader integrated statutory program against fraud and misrepresentation in the sale of securities—the part which authorizes civil recovery.[15] Prior to the Securities Act of 1933, securities frauds were dealt with federally on a somewhat limited basis under the mail fraud and conspiracy statutes, infractions of which gave rise to criminal liability.[16] The Securities Act has greater impact. It provides federal legislation tailored to the securities field. As previously noted, not only are there criminal sanctions for the violation of Section 17, but the Commission is authorized to enjoin a threatened violation,[17] and an investor may obtain private relief in an action for damages or rescission. Moreover, civil recovery may be had for material misstatements or half-truths which may or may not constitute "fraud". The Securities Act of 1933 not

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[15] See also the following observation of Representative Rayburn, Chairman of the House Committee which passed upon the bill which became the Securities Act: "It makes [the seller] responsible civilly if he sells stocks upon a misrepresentation; it makes him guilty of fraud and criminally liable if he sells it [sic] with misrepresentation and fraudulent intent." 77 Cong. Rec. 2919.

[16] 18 U.S.C. 371, 1341. The mail fraud statute imposes criminal sanctions upon persons who, having devised or intending to devise a fraudulent scheme, "for the purpose of executing such scheme * * * or attempting so to do", use or cause the mails to be used. Clearly the misrepresentations need not be sent through the mails. *Pereira* v. *United States*, No. 50, this Term, decided February 1, 1954.

[17] Section 20(b), 15 U.S.C. 77t(b), authorizes injunctive relief against threatened violations of Section 17. Criminal penalties for willful violations are provided by Section 24, 15 U.S.C. 77x.

only goes far beyond the mail fraud statute in the securities field, but, for the most part, well beyond local law in dealing with misrepresentation and fraud in securities transactions. *Wilko* v. *Swan*, 346 U. S. 427, 430-31, 435, 438; *S.E.C.* v. *C.M. Joiner Leasing Corp.*, 320 U. S. 344, 353; *cf. S.E.C.* v. *W. J. Howey Co.*, 328 U. S. 293, 301. [18]

Section 17(a) (set forth in full at page 3, *supra*) is the counterpart of Section 12(2) in that it subjects the same type of fraud to Commission injunction or criminal prosecution. Subparagraph (2) of Section 17(a) makes unlawful the same misrepresentations and half-truths described in the civil recovery provisions of Section 12(2). The provisions of Section 17(a) as respects the requisite use of the mails or instrumentalities of interstate commerce are phrased a little differently than those of Section 12(2), apparently as the result of the difference in the type of legal action authorized. Section 17(a)(2) renders it "unlawful for any person in the sale of any securities * * * by the use of the mails, directly or indirectly * * * to obtain money or property by means of any untrue statement of material fact", etc. [19] Section

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[18] The mail fraud statute was not repealed by implication by the passage of the comprehensive provisions of the Securities Act of 1933. *Edwards* v. *United States*, 312 U. S. 473; *United States* v. *Rollnick*, 91 F. 2d 911 (C.A. 2).

[19] Section 17(b), on the other hand, clearly limits the prohibition of "touting", as distinguished from fraudulent "sales", to communications sent in interstate commerce or through the mails. Thus Congress knew how to draft provisions to achieve the limited construction urged by the petitioners when it desired to do so.

17(a), as the courts have held with unanimity, applies whenever the mails are used in the sale transaction, or in furtherance of the fraudulent scheme, irrespective of whether misrepresentations or half-truths have been transmitted through the mails.[20] "The character of the matter sent by mail is immaterial" where the mailing is connected with the fraudulent sale.[21]

Relevant also are the court decisions under Section 10 (b) of the companion Securities Exchange Act of 1934, 48 Stat. 881, 15 U.S.C. 78j(b). Section 10 (b) authorizes the Commission to promulgate rules rendering unlawful deceptive *purchases,* as well as deceptive sales, of securities. Pursuant to that section, the Commission has promulgated Rule X-10B-5 upon the pattern of Section 17 (a) of the Securities Act of 1933, but applicable to purchases

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[20] Examples of mailings held sufficient are: mailings of warranty deeds between defendants, and to the county clerk for recording and subsequent delivery to investors, *Mansfield* v. *United States,* 155 F. 2d 952 (C.A. 5), certiorari denied *sub nom. Browne* v. *United States,* 329 U. S. 792; mailings acknowledging part payment and transmitting deeds, *United States* v. *Earnhardt,* 153 F. 2d 472 (C.A. 7), certiorari denied, 328 U.S. 858; a mailing requesting delivery of securities to a third person and a reply by mail stating that this had been done, *Bogy* v. *United States,* 96 F. 2d 734 (C.A. 6), certiorari denied, 305 U. S. 608; mailings by defendants' agents to defendants containing reports relating to the execution of the fraudulent scheme and remitting bank drafts, *United States* v. *Monjar,* 47 F. Supp. 421 (D. Del.), affirmed, 147 F. 2d 916 (C. A. 3), certiorari denied, 325 U. S. 859; delivery of stock certificate after oral contract of sale and receipt of payment, *S.E.C.* v. *Wimer,* 75 F. Supp. 955 (W.D.Pa.); mailing by a bank to effect collection of a check representing the receipts of defendant's fraud, *United States* v. *Vidaver,* 73 Supp. 382 (E.D. Va.).

[21] *S.E.C.* v. *Timetrust, Inc.,* 28 F. Supp. 34, 42 (N.D. Calif.).

as well as sales.[22] In addition to providing a basis for governmental action by way of injunction or criminal prosecution,[23] the violation of Rule X-10B-5, as the courts have recognized, gives rise to a private cause of action for civil recovery in favor of a defrauded seller.[24] Rule X-10B-5, thus, constitutes another counterpart of Section 12(2) of the Securities Act in rounding out the program of

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[22] Rule X-10B-5, 17 C.F.R. 240.10b-5, provides:

"It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange,

(a) To employ any device, scheme, or artifice to defraud,

(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,

in connection with the purchase or sale of any security."

[23] See Sections 21(e) and 32 of the Securities Exchange Act of 1934, 15 U.S.C. 78u(e), 78ff.

[24] See, *e.g.*, *Fratt* v. *Robinson*, 203 F. 2d 627 (C.A. 9); *Fischman* v. *Raytheon Mfg. Co.*, 188 F. 2d 783 (C.A. 2); *Slavin* v. *Germantown Fire Ins. Co.*, 174 F. 2d 799 (C.A. 3); *Kardon* v. *National Gypsum Co.*, 69 F. Supp. 512 (E.D. Pa.); *Speed* v. *Transamerica Corp.*, 71 F. Supp. 457 (D. Del.), and 99 F. Supp. 808 (D. Del.); *Northern Trust Co.* v. *Essaness Theatres Corp.*, 103 F. Supp. 954 (N.D. Ill.). The right of action has been based on the tort doctrine that a person injured by another's violation of a statute intended for his protection may seek private relief if the statute does not withhold relief or make other provision for private relief inconsistent with the application of the tort doctrine, and upon the provisions of Section 29(b) of the Securities Exchange Act of 1934, 15 U.S.C. 77cc(b), rendering void contracts made in violation of the statute or rules thereunder and containing other provisions consistent with the right of a defrauded seller to seek private recovery.

Congress. "The two Acts," it has been held, "are unquestionably in pari materia and must be construed together to make a consistent whole." *Rosenberg* v. *Globe Aircraft Corp.*, 80 F. Supp. 123, 124 (E.D. Pa.). Consistent with the construction given the mailings provision of Section 17(a) of the 1933 Act, it has been held that a seller may obtain civil recovery under Rule X-10B-5 for oral misrepresentations where the mails have been used at any point in connection with the fraudulent purchase. See, *e.g.*, *Fratt* v. *Robinson*, 203 F. 2d 627 (C.A. 9); *Northern Trust Co.* v. *Essaness Theatres Corp.*, 103 F. Supp. 954 (N.D. Ill.).

It has been recognized that the requirements in the anti-fraud provisions of these two statutes relating to the use of interstate commerce or the mails were not intended to set forth the gist of the offenses, but merely to establish the source of the power exercised by Congress to reach the interdicted fraud or deceit.[25] Stated differently, the "jurisdictional language" was intended to provide constitutional support for the broad statutory program adopted; and Congress intended to make full

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[25] See *Fratt* v. *Robinson*, 203 F. 2d 627, 635 (C.A. 9) ("* * * the use of the mails *per se* is not denounced, it is the fraud that offends. For that reason, it [the statute] denies the use of the mails in connection with the fraud."); *United States* v. *Monjar*, 47 F. Supp. 421, 425 (D. Del.), affirmed, 147 F. 2d 916 (C.A. 3), certiorari denied, 325 U. S. 859 ("The target at which the act aims is the scheme to defraud. True, use of the mails or the facilities of interstate commerce is the basis of federal jurisdiction"). See also *United States* v. *Kott*, 1 SEC Jud. Dec. 228, 229 (S.D. Tex.), reversed on other grounds, *Seeman* v. *United States*, 90 F. 2d 88 (C.A. 5); *cf. Kopald-Quinn & Co.* v. *United States*, 101 F. 2d 628, 632-33 (C.A. 5), certiorari denied, *sub nom. Ricebaum* v. *United States*, 307 U.S. 628.

use of its constitutional powers to achieve the remedial objectives of the legislation. It has already been shown that there has been no dissent from this view in the construction of the companion provisions of Section 17 (a) of the 1933 Act and Rule X-10B-5 under Section 10(b) of the 1934 Act; and, as we show more fully below, only one court of appeals has adopted a different view of the purpose of the "jurisdictional language" of Section 12(2). See pp. 33-36, *infra*. If the view of that court should prevail, the result would be that there could be no civil recovery under Section 12 (2) of the Securities Act of 1933 for sales induced by oral "face-to-face" fraudulent misrepresentation, even though the very same conduct could be enjoined or criminally prosecuted by virtue of Section 17 (a) of that Act, and even though the very same conduct on the part of a buyer of securities would afford a basis for civil recovery by the defrauded seller pursuant to Rule X-10B-5 under the companion Securities Exchange Act of 1934. For reasons previously stated, Section 12 (2) is not reasonably susceptible of such a construction. It is unlikely that Congress could have intended so incongruous a result. Surely a Congress aware of the fact that many securities frauds were induced by oral misrepresentations, and "trying to cover instances where there seem to be loopholes and means of escape" (77 Cong. Rec. 2983), did not intend to authorize easy evasion of a civil recovery provision deemed of paramount importance in preventing "further exploitation of the public by the

sale of unsound, fraudulent, and worthless securities through misrepresentation." S. Rep. No. 47, 73d Cong., 1st Sess. (1933), p. 1.

Petitioners' argument that the federal securities statutes were not intended to reach "local controversies"[26] is similar to the contention recently rejected by the Court of Appeals for the Ninth Circuit in *Fratt* v. *Robinson,* 203 F. 2d 627, where it had been urged that the companion anti-fraud provisions of Rule X-10B-5 promulgated pursuant to Section 10(b) of the 1934 Act could have no applicability to transactions in securities which had never been publicly traded on an exchange or in the over-the-counter market. Contrary to the view now urged by petitioners, that court held that the federal securities laws were intended to be of broad scope as respects fraudulent and deceptive transactions, and to reach, *inter alia,* intrastate and even private securities transactions involving use of the mails. Other federal courts have agreed with this construction.[27] Petitioners' professed concern that

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[26] It may be pertinent to recall that petitioners' repeated references to "local controversy" appear to be at variance with the disclosure in their own brief that many out of state residents were induced to invest in the promotion and have instituted other actions based on diversity of citizenship. See n. 1, *supra,* p. 4.

[27] *Robinson* v. *Difford,* 92 F. Supp. 145 (E.D. Pa.); *Speed* v. *Transamerica Corp.,* 99 F. Supp. 808 (D. Del.); *Northern Trust Co.* v. *Essaness Theatres Corp.,* 103 F. Supp. 954 (N.D. Ill.). See also *Llanos* v. *United States,* 206 F. 2d 852 (C.A. 9), certiorari denied, 346 U.S. 923, where the court rejected an argument similar to that advanced by the instant petitioners (Pet. Br. 16-17), that the giving of promissory notes in exchange for personal loans did not involve sales of securities within the meaning of the 1933 Act because Congress never intended the statute to be applicable to personal transactions such as these.

the ruling below will "flood the federal courts" [28] with local disputes apparently does not extend to local controversies involving mailed *written* misrepresentations, rather than *oral* misstatements. They readily concede that even under their proffered construction, "Section 12(2) would still apply to a purely local transaction where a prospectus was sent through the mails within a single state and was used to sell a security" (Pet. Br. 24). Petitioners offer no satisfactory reason why Congress would want to afford a federal civil remedy for written misrepresentations even as respects a "local controversy", but deny one for the same misrepresentations if made orally; and, of course, it seems clear enough that Congress never contemplated such a distinction.

The legislative history of Section 12(2) supports our construction. The language of Section 12(2) first appeared in the House bill. H. R. 5480, 73d Cong., 1st Sess. (1933). While different in terminology, the civil liabilities provisions of the Senate bill were substantially as broad, but contained no "jurisdictional language". [29] The omis-

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[28] No such "flood" has resulted from the decision in *Schillner v. H. Vaughan Clarke & Co.*, 134 F. 2d 875 (C.A. 2), handed down in 1943, which the court below followed. Certainly, the remedy for an overworked federal judiciary does not lie in misconstruction of remedial federal legislation, but elsewhere.

[29] In relevant part, the Senate bill read as follows (S. 875, 73d Cong., 1st Sess. (1933), 77 Cong. Rec. 2979, 2981):

> * * * Every person acquiring any security by reason of any false or deceptive representation made in the course of or in connection with a sale or an offer for sale or distribution of such securities shall have the right to recover any and all damages suffered by reason of such acquisition of such securities from the person or persons

sion seemingly resulted from the preoccupation of the Senate draftsmen with the basic purpose of providing a federal civil remedy for misrepresentation and fraud in the sale of securities.[30] Notwithstanding the omission, in the Conference Report the managers on the part of the House, comparing the two provisions, characterized them as "substantially similar".[31] It described the section as one imposing "civil liability for using the mails or the facilities of interstate commerce to sell securities * * * by means of representations which are untrue or are misleading by reason of omissions of material facts."[32] Thus the jurisdiction limits were applied to the sales, not to the representations.

The congressional debates provide further support for the construction adopted by the court below. Members of Congress showed particular concern about the inadequacy of state "blue sky" laws to deter or prevent fraudulent securities transactions, and about the need for employing the comprehensive powers of Congress in this regard.[33] The inability of individual states to cope adequately with the problems presented by the securities industry which, as a whole, is interstate in character, admittedly was the primary factor in bringing

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signing, issuing, using, or causing, directly or indirectly, such false or deceptive representation, jointly or severally * * *.

[30] See S. Rep. No. 47, 73d Cong., 1st Sess. (1933), p. 1.

[31] Conference Report, H. Rep. No. 152, 73d Cong., 1st Sess. (1933), pp. 26-27.

[32] *Ibid.*

[33] See 77 Cong. Rec. 2912, 2914, 2918, 2920, 2930-31, 2935, 2953-54.

about federal legislation; and petitioners highlight this in the portions of the legislative debates referred to in their brief. Some of their other references, relating to the exclusion of intrastate transactions, have no pertinency here since they were concerned with the registration provisions of the statute.[34] None of petitioners' references involve specific discussion of the statutory program in Sections 12(2) and 17(a) with respect to fraudulent and deceptive sales. There are, however, positive indications in the legislative history that Congress intended to make full use of its constitutional powers in dealing with such sales. During the course of the House debates, Representative—and former Solicitor General—Beck pointed out that those powers were twofold: "One, the power of the United States over post roads, and therefore the mails; and the other, the commerce clause." "The power over the mails," he thought, "is a much broader power than the power over interstate commerce." 77 Cong. Rec. 2935. In the course of the Senate debate, Senator Fletcher, Chairman of the Senate Committee which held hearings on the bill, also explained that the pro-

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[34] For example, the quotations from the Committee reports on page 23 of petitioners' brief.

Other quotations from the floor debates relied upon by petitioners (Pet. Br. 20-21) appear to be casual and generalized statements made without consideration of the statutory provisions relating to the use of the mails—statements which petitioners themselves cannot consistently accept as accurate in view of petitioners' agreement as to the sufficiency of intrastate mailings of written misrepresentations. Compare Mr. Justice Jackson's observation in *Schwegmann Bros.* v. *Calvert Distillers Corp.*, 341 U.S. 384, at 396.

posed statute was jurisdictionally based not only on the commerce clause but also on the fact that "the securities also move in the mails". 77 Cong. Rec. 2983. This is in harmony with Senator Norbeck's later comment that "in the pending bill the authority of the Government rests largely on the fact that the mails are used in the transaction of this business * * *" 77 Cong. Rec. 3223. These jurisdictional bases appeared in various portions of the Senate bill but, as we have already pointed out, jurisdictional language inadvertently was omitted from the civil liabilities provisions of the Senate proposal. The foregoing indicates, however, that the Senate intended to exercise comprehensively any postal powers Congress possessed. Such comprehensive exercise of jurisdiction, of course, would include transportation of the security or other uses of the mails not involving communication of the misrepresentations complained of. When Senator Wheeler observed that the mail fraud statute (18 U.S.C. 1341) already covered the situation of oral misrepresentations followed by a mailing of the security itself or other material (77 Cong. Rec. 2983), Senator Fletcher remarked that the proposed legislation does not "in any wise restrict or limit or weaken the laws already on the statute books," but rather "strengthens and broadens the authority to proceed in such instances." 77 Cong. Rec. 2983, 2984.

In articles published shortly after passage of the Act, eminent authorities read Section 12(2) as did the court below. See, *e.g.*, Douglas and Bates,

The Federal Securities Act of 1933, 43 Yale L. J. 171, 177, 183, n. 51, 209, n. 213 (1933); Frankfurter, *The Federal Securities Act: II,* 8 Fortune 53, 108 (1933); Dean, *The Federal Securities Act: I,* 8 Fortune 50, 102 (1933); see also Dodd, *Amending the Securities Act—The American Bar Association Committee's Proposals,* 45 Yale L. J. 199, 223 (1935). It was not until years later that language inaccurately paraphrasing Section 12(2) crept into some court dicta, thus affording a semblance of authority for a construction which offered wide opportunities for circumvention of the statute.

This brings us to the cases under Section 12(2). All but one of the court holdings support the construction urged herein. In addition to the holding below of the Court of Appeals for the Fifth Circuit, there is the ruling of the Court of Appeals for the Second Circuit in *Schillner* v. *H. Vaughan Clarke & Co.,* 134 F. 2d 875. In that case defendants sold stock by oral misrepresentations made to plaintiffs at their home. The only use of the mails was to deliver the stock certificates from defendants' office in Philadelphia, Pa., to plaintiffs' home in Rome, New York. In rejecting defendants' argument that Section 12(2) had no application because the misrepresentations had not been transmitted by mail or by use of interstate facilities, Judge Swan stated (134 F. 2d, at 877):

> We do not think that this is the inevitable, or even the most natural, meaning of the statutory language. Liability to repay the consideration received is imposed upon any person who

> "sells a security * * * by the use of any means or instruments of transportation or communication in interstate commerce or of the mails, by means of a prospectus or oral communication" of the untrue or misleading character described in the section. To accept appellant's construction would render the phrase "oral communication" of most limited application because the section would then reach only interstate telephone calls or conversations where the parties might be talking across a state line. *It would seem much more likely that Congress intended to make the statute applicable if one sells a security by use of the mails, even though the seller's untrue or misleading statement is communicated orally and intrastate.* [Emphasis added.]

In *Moore* v. *Gorman,* 75 F. Supp. 453 (S.D. N.Y.), defendants made oral misrepresentations and concluded an oral agreement of sale in Philadelphia. Defendants' agent, however, made a round trip by rail between Philadelphia, Pa., and New York City, N. Y., in order to deliver the securities and bring back plaintiff's check in payment. Dedefendants moved to dismiss on the ground, *inter alia,* that no misrepresentation was transmitted by interstate facilities. The motion was denied on the authority and reasoning of the *Schillner* case.

Recently, in *Fratt* v. *Robinson,* 203 F. 2d 627, the Court of Appeals for the Ninth Circuit had occasion to consider the "jurisdictional language" of Section 12(2) in passing upon a similar contention that Rule X-10B-5 under the 1934 Act was inap-

plicable where the misrepresentations were oral and intrastate. In rejecting that construction of Rule X-10B-5, Judge Stephens also reviewed the holdings and dicta under Section 12(2) and expressed agreement with the view adopted in the *Schillner* and *Moore* cases (203 F. 2d, at 634, n. 20).

On the other hand, petitioners' proffered construction finds support in the decision of the Court of Appeals for the Seventh Circuit in *Kemper* v. *Lohnes,* 173 F. 2d 44, and in certain paraphrasings of Section 12(2) by some other courts which, with one possible exception, are clearly dicta. In none of these cases is there any analysis of the statutory considerations. In the *Kemper* case the complaint alleged that, in response to defendant's newspaper advertisement, plaintiff advised defendant by mail of his interest in purchasing certain stock; that defendant replied by mail arranging for a meeting; and that at this and subsequent meetings defendants made the material misrepresentations which induced the sale. Both parties were residents of Chicago and everything took place in that city. The court held Section 12(2) inapplicable. It assumed the answer to the critical question at the very outset when it started with the premise that Section 12(2) requires that the misrepresentations be transmitted either by use of interstate facilities or of the mails. Since an oral misrepresentation obviously cannot be transmitted through the mails, the court concluded that the statutory phrase "oral communication" must refer only to misrepresenta-

tions communicated through interstate facilities—*e.g.*, "telephone conversations * * * in interstate commerce and perhaps broadcasts by radio" (173 F. 2d, at 45-46). Likewise, there is no supporting discussion for the early statement in *Siebenthaler* v. *Aircraft Accessories Corp.*, CCH Fed. Sec. L. Rep. ¶ 90,122 (W.D. Mo. 1940), and early dicta in two other cases. In the *Siebenthaler* case there is a brief statement in the numbered conclusions of law that Section 12 was not applicable, "there being no prospectus and no oral communication involving the means or instruments of transportation or communication in Interstate Commerce". The actual holding in that case is not clear; for there was no positive finding of any fraudulent misrepresentation or omission.[35] In *Murphy* v. *Cady*, 30 F. Supp. 466 (D. Me., 1939), affirmed, 113 F. 2d 988 (C.A. 1, 1940), certiorari denied, 311 U.S. 705, plaintiff recovered on proof of oral misrepresentations communicated by interstate telephone.[36] Similarly, in *Independence Shares Corp.* v. *Deckert*, 108 F. 2d 51 (C.A. 3, 1939), reversed without discussion of point, 311 U.S. 282, the alleged mis-

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[35] The *Siebenthaler* case has been criticized because its "narrow construction" would "seriously impair the scope of the section, and must be abandoned if the section is to be of any real use to injured investors." Comment, *Civil Liability under the Federal Securities Act*, 50 Yale L. J. 90, 101 (1940).

[36] See, however, the later observation of the Court of Appeals for the First Circuit in *Crooker* v. *S.E.C.*, 161 F. 2d 944, 947 (1947): "Any person who sells a security in interstate commerce by means of an untrue or misleading statement of material facts in a prospectus or oral communication is subject to civil liability under § 12(2), and to criminal penalties as provided in §§ 17 and 24."

representations were transmitted by use of interstate instrumentalities. At a later stage of the proceedings in that case, the court observed: "The gravamen of the cause of action * * * is the misleading of the purchaser." *Pennsylvania Co.* v. *Deckert*, 123 F. 2d 979, 984 (C.A. 3). The *Kemper* decision has not been followed. Rather, as shown above, it has since been disapproved by two courts of appeals.

For the reasons stated, the court below correctly decided that Section 12(2) applies where the mails have been used in the fraudulent sale, even though the particular misrepresentations were oral and intrastate. We turn now to the question whether the mailings here alleged were mailings in the sale of the securities.

II. The Alleged Uses of the Mails to Deliver the Documents Essential to the Investment Contracts Are Mailings in the Sale of the Securities under Section 12(2) of the Act.

We agree with the court below that the alleged uses of the mails to consummate the sales by delivery of the documents which were essential parts of the investment contracts, *viz.*, the warranty deeds and the care contracts, sufficed to bring the transactions within the ambit of Section 12(2) (R. 54). Petitioners, on the other hand, assert that the transactions were complete when the contracts were agreed upon and the deeds made out and recorded,[37] so that the delivery of the deeds through the mails conferred no additional rights (Pet. Br. 12). This argument starts from a false premise and follows

[37] See note 4, *supra*, p. 6.

it to a false conclusion. We are not dealing here with "a simple real estate sale" (Pet. Br. 16). The court below held that the transactions alleged in the complaint involved the sale of investment contracts of which the transfer of the title to land was but a part. The securities consist of the entire agreements between the sellers and the buyers, including specifically the "care contracts". It appears from the dates recited in the complaint that these contracts were not actually completed during the initial interviews, but were filled in and dated at a later time and then forwarded through the mails to the investors. It is futile therefore to speculate on whether sales of land are completed by the recording of deeds under the real property law of Texas, for the simple reason that we are not concerned with the transfer of title to land as such.[38] While we do not regard it as essential to the applicability of Section 12(2) that completion of the care contracts was thus delayed—in view of the broad statutory definition of the term "sell" and the court decisions construing Sections 12(2) and 17(a) as applicable where the mails are used to deliver stock certificates after completion of the initial contract, to which we refer below—there is no doubt that, in the instant case, the sales transactions were not completed until the documents were in fact delivered through the mails.

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[38] If the real property law of Texas were deemed relevant, it is significant that delivery of a deed is deemed essential to transfer title to land. Vernon's Tex. Rev. Civ. Stat. Ann. Art. 1288; *Steffian* v. *Milmo National Bank*, 69 Tex. 513, 6 S.W. 823; *McGowen* v. *Montgomery*, 248 S.W. 2d 789 (Tex. Civ. App.).

Section 12(2) applies to any person who "sells a security * * * by the use * * * of the mails * * *" The terms "sale" and "sell" are defined by Section 2(3), 15 U.S.C. § 77b(3), to "include every contract of sale or *disposition of, attempt* or offer *to dispose of* * * * a security * * * for value * * *" (emphasis added). This language on its face covers the use of the mails in effectuating any portion of the sale transaction, including consummation by delivery of the security.[39] This has been the uniform construction of the comparable language of Section 17(a)—"in the sale of any securities * * * by the use of the mails"—and of the similar language of Rule X-10B-5—"by the use of * * * the mails * * * in connection with the purchase or sale of any security." See the cases set forth in pp. 24-26, *supra*.

The cases holding that Section 12(2), also, requires only that any of the stated federal instrumentalities be used in the sale transaction likewise agree that it is sufficient if the mails are used in consummation of the transaction. Thus, as previously indicated, the use of the mails or instrumentalities of interstate commerce to deliver the securities has been held sufficient not only by the court below, but also by the Court of Appeals for the Second Circuit in *Schillner* v. *H. Vaughan Clarke & Co.*, 134 F. 2d 875, and by a federal district court in *Moore* v. *Gorman*, 75 F. Supp. 453 (S.D. N.Y.). See

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[39] The definition, it was contemplated, would operate "broadly." See H. Rep. No. 85, 73d Cong., 1st Sess. (1933), p. 11.

also *S.E.C.* v. *Wimer*, 75 F. Supp. 955 (W.D. Pa.), holding that delivery of securities by mail from one state to another involves a "sale" at the place of delivery within the meaning of the venue provisions of Section 22(a) of the Act, 15 U.S.C. § 77v(a). In the *Moore* case, *supra*, the court also referred to the use of instrumentalities of interstate commerce to collect payment for the securities sold there as a basis for jurisdiction under Section 12(2). 75 F. Supp., at 456-57.

The sole contrary judicial authority, to our knowledge, is a statement in *Gross* v. *Independence Shares Corp.*, 36 F. Supp. 541 (E.D. Pa.), that the use of the mails to deliver the security is not a use in the sale of the security within the meaning of Section 12(2).[40] Judge Bard pointed to the fact that the registration provisions of Section 5(a)(2), 15 U.S.C. § 77e(a)(2), expressly rendered unlawful, among other things, the use of the mails "for delivery after sale" of an unregistered security. The absence of any express reference to "delivery" in Section 12(2), he thought, indicated that such use of the mails would not be suf-

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[40] The court held sufficient other mailings in that case—mailings of payment notices and other material designed to induce investors to continue contracts relating to securities sold under an installment payment plan. It should be observed that, in the present case, the complaint similarly alleges that the periodic billings on the care contracts contain misrepresentations intended to induce respondents to continue payments pursuant to the investment arrangements and to deter withdrawals therefrom. If the complaint can be viewed as alleging sales which partially, at least, were on an installment basis, these mailings would appear sufficient even under petitioners' thesis.

ficient under that section. The *Gross* statement was considered and rejected by the Court of Appeals for the Second Circuit in the *Schillner* case (134 F. 2d, at 877-78). As Judge Swan pointed out, whereas Section 5(a)(2) refers to mailings to make "delivery after sale", Section 5(a)(1) renders unlawful the use of the mails to "sell" an unregistered security, without any reference to delivery. Both civil recovery provisions of Section 12 likewise simply use the word "sells". Section 12(1) imposes civil liability upon any person who "sells" in violation of the registration requirements of Section 5. Section 12(2) imposes liability upon one who "sells" by misrepresentations or half-truths. If the word "sells" is construed consistently in Section 12 to exclude delivery after sale, Section 12(1) would then be limited in scope to violations of only part of Section 5(a). This, Judge Swan reasoned, would be clearly contrary to the intent of Congress, particularly in light of the fact that the statute imposes criminal liability for violation of any part of Section 5(a). The word "sells", he concluded, must be taken to include delivery of the security if Section 12(1) is to be given its full meaning; and there was no warrant for giving a different meaning to the same word as used in Section 12(2). Moreover, he pointed out, such construction fully accords with the broad definition of the term "sell" in Section 2(3) which includes the *"disposition"* of the security.

Judge Swan recognized that since Section 5(a)

(2) differentiated between the use of the mails to sell and the use of the mails to deliver after sale, the word "sell" may have narrower meaning in Section 5(a)(2) than in Section 12. The broad Section 2 definition applies "unless the context otherwise requires". The context of the registration provisions of Section 5 is different, as we have already shown. The appropriate reference in the construction of Section 12(2) is the basic statutory definition and not the language employed in Section 5. The *Gross* statement, followed to its logical end, would also apply to the anti-fraud provisions of Section 17(a), and perhaps Rule X-10B-5 under the 1934 Act, so as to render insufficient under those provisions uses of the mails to effect or obtain delivery of securities sold or purchased by misrepresentation and fraud. We have previously shown that this is contrary to the uniform holdings of the courts. See pp. 24-26, *supra*.

For the reasons stated, we believe it clear that the court below also properly decided that the complaint alleges uses of the mails in the sale of the securities within the meaning of Section 12(2).

CONCLUSION

The judgment below should be affirmed.

Respectfully submitted,

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